Internal Revenue Service

memorandum

CC:INTL-0474-95
Br1:WEWilliams

date: MAY 23 1995

to: Chief, Examination Branch CP:IN:D:C:66

from: Chief, Branch No. 1
Associate Chief Counsel (International) CC:INTL:1

subject: [redacted]

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This responds to your request that we review a proposed letter to a taxpayer. As explained below, the issue involves the taxability of income from a license permitting the use of photographs that taxpayer may grant to a U.S. publisher.

Background:

According to your proposed letter to the taxpayer, [redacted] (hereafter "[redacted]") is a Delaware corporation that has one employee, [redacted] is a well-known photographer and an alien who is a resident of [redacted]. [redacted] contracted to sell [redacted] services to the [redacted] (hereafter "[redacted]") to take photographs for [redacted], a magazine owned by [redacted]. Under this contract, all photographs that [redacted] takes for [redacted] are the property of [redacted]. However, the contract provides that [redacted] may consent to allow [redacted] to use the photographs (e.g., in a publication of [redacted] artistic works). The contract requires that [redacted] percent of any income from such use of the photographs be paid to [redacted].

You are examining corporate income tax returns filed by [redacted] and also individual income tax returns filed by [redacted]. Although not an issue in your examination, taxpayers asked for your comments on the following question. A U.S. company may publish a book of [redacted] photographs, some of which will be the property of [redacted] and used with [redacted] permission. [redacted] will be paid royalties by the publisher for the latter's use of the

photographs in the book. [redacted] percent of the royalties received by [redacted] attributable to photographs owned by [redacted] will be paid to [redacted]. Some of the photographs were taken outside of the U.S., and the compensation that [redacted] received for taking these pictures was from sources outside the U.S. and not subject to U.S. income tax.

The question is whether any of the royalties received by [redacted] are subject to [redacted] income tax on the theory that some of the photographs were produced by [redacted] in prior years outside of the U.S.; and that since as a nonresident alien the compensation he received for such photographs was not subject to U.S. tax[1]/, royalties received by [redacted] for the use of the photographs should also not be subject to U.S. tax. The question does not concern the taxability of income that [redacted] receives from [redacted]

Discussion:

Your proposed memorandum concludes that [redacted] has a permanent establishment in the U.S.; and that

> [u]nder Article [redacted] [Fiscal Domicile] of the [U.S.-[redacted]] Income Tax Treaty, ... [it] is a corporate resident of the United States and its worldwide income which falls under the provisions of Article 4 [Permanent Establishment], [redacted] [Business Profits] and [redacted] [Royalties] ... is taxable in the U.S.

We do not agree that the Convention is the basis for subjecting the income in question to U.S. taxation. [redacted] is a U.S. corporation, and therefore, the taxability of its income is determined under U.S. law and not under the U.S.-[redacted] Income Tax Convention (hereafter "the Convention"). In this regard, Article [redacted] of the Convention defines the term "resident of the United States" as including a U.S. corporation. With certain exceptions not applicable here, Article [redacted] of the Convention states that "[t]he United States may tax its citizens and residents as if the present Convention had not come into effect. [Emphasis added.]"

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[1]/ For U.S. tax purposes, gross income of a nonresident alien, i.e., [redacted] includes noneffectively connected income from sources within the U.S. and income from any source that is effectively connected with the conduct of a trade or business within the U.S. See I.R.C. § 872(a) and Treas. Reg. § 1.872-1(a)(1).

As a U.S. corporation, [redacted] is subject to U.S. income tax on its worldwide income. Double taxation is avoided through the allowance of credits for foreign taxes paid on non-U.S. source income.[2]/ Therefore, whether [redacted] has a U.S. permanent establishment is not relevant.

Under section 61(a),

> gross income means all income from whatever source derived, including (but not limited to) the following items:
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> * * *
>
> (6) Royalties; ....

It is likely that the IRS position would be that there is no basis for [redacted] to tax the royalties in question and, therefore, that a foreign tax credit on [redacted] U.S. tax return is inappropriate.

Section 861(a)(4) provides in relevant part that rentals or royalties for the use of or for the privilege of using copyrights in the U.S. shall be treated as income from sources within the U.S. Therefore, to the extent that [redacted] licenses a publisher to use the photographs in books to be sold in the U.S., U.S. law is that royalties paid pursuant to the license have a U.S. source. Therefore, the IRS position would be that such royalties are not subject to [redacted] tax.[3]/

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[2]/ In explaining the amendments to the foreign tax credit provisions in the Tax Reform Act of 1986, P.L. 99-514, the Senate Finance Committee Report states the following:

> The United States taxes U.S. persons on their worldwide income, including their foreign income. Congress enacted the foreign tax credit ... to prevent U.S. taxpayers from being taxed twice on their foreign income-once by the foreign country where the income is earned, and again by the United States. The foreign tax credit generally allows U.S. taxpayers to reduce the U.S. tax on their foreign income by the foreign income taxes they pay on that income.

S. Rep. No. 99-313, 99th Cong., 2d Sess. 293 (May 29, 1986).

[3]/ See, e.g., Rev. Rul. 84-144, 1984-2 C.B. 129, which determines the source of income, and the allowance of a foreign tax credit, on a rollover from a qualified pension trust to an IRA on the basis of the rules for sourcing income from personal

Further, to the extent that [redacted] licenses a publisher to use the photographs in books sold in [redacted] Article [redacted] of the U.S. [redacted] Income Tax Convention is relevant. Paragraph [redacted] of Article [redacted] provides as follows:

> Royalties derived from copyrights of literary, artistic, or scientific works ... by a resident of one Contracting State shall be taxable only in that Contracting State.

As a U.S. corporation, [redacted] is a resident of the U.S. See Article [redacted] of the Convention. Therefore, royalties it receives from use of its photographs in [redacted] is taxable only by the U.S.

We suggest that your letter be revised to state that the gross income of [redacted] is determined under U.S. law and not under the Convention. Further, to the extent that [redacted] receives royalties from a U.S. publisher for use of the photographs in books sold in the U.S., the income is from a U.S. source and subject only to U.S. income tax. I.R.C. § 861(a)(3). To the extent that royalties are related to use of the photographs in books sold in [redacted] the income would be taxable only in the U.S. under Article [redacted] of the Convention.

If you have any questions concerning this matter or if we can be of further assistance, please call Ed Williams at 874-1490.

GEORGE M. SELLINGER

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services under sections 861(a)(3) and 862(a)(3).